

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLANT**

ORIGINAL

74-1272

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P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

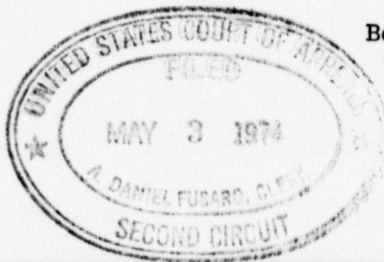
JEFF SIMON, as Custodian for GAIL NINA SIMON, Under the
New York Uniform Gifts to Minors Act, *Appellant,*

—against—

THE NEW HAVEN BOARD & CARTON COMPANY, INCOR-
PORATED, EDWIN W. MILLER, STERLING R. CHATFIELD,
WILLIAM B. GUMBARD, LEON J. SIMKINS, MORTON H.
SIMKINS, DOROTHY SIMKINS, LEON MELTZER, JACOB J.
SIEGAL, and MALCOLM SANDERS, *Appellees.*

**On Appeal from the United States District Court
for the District of Connecticut**

APPELLANT'S BRIEF



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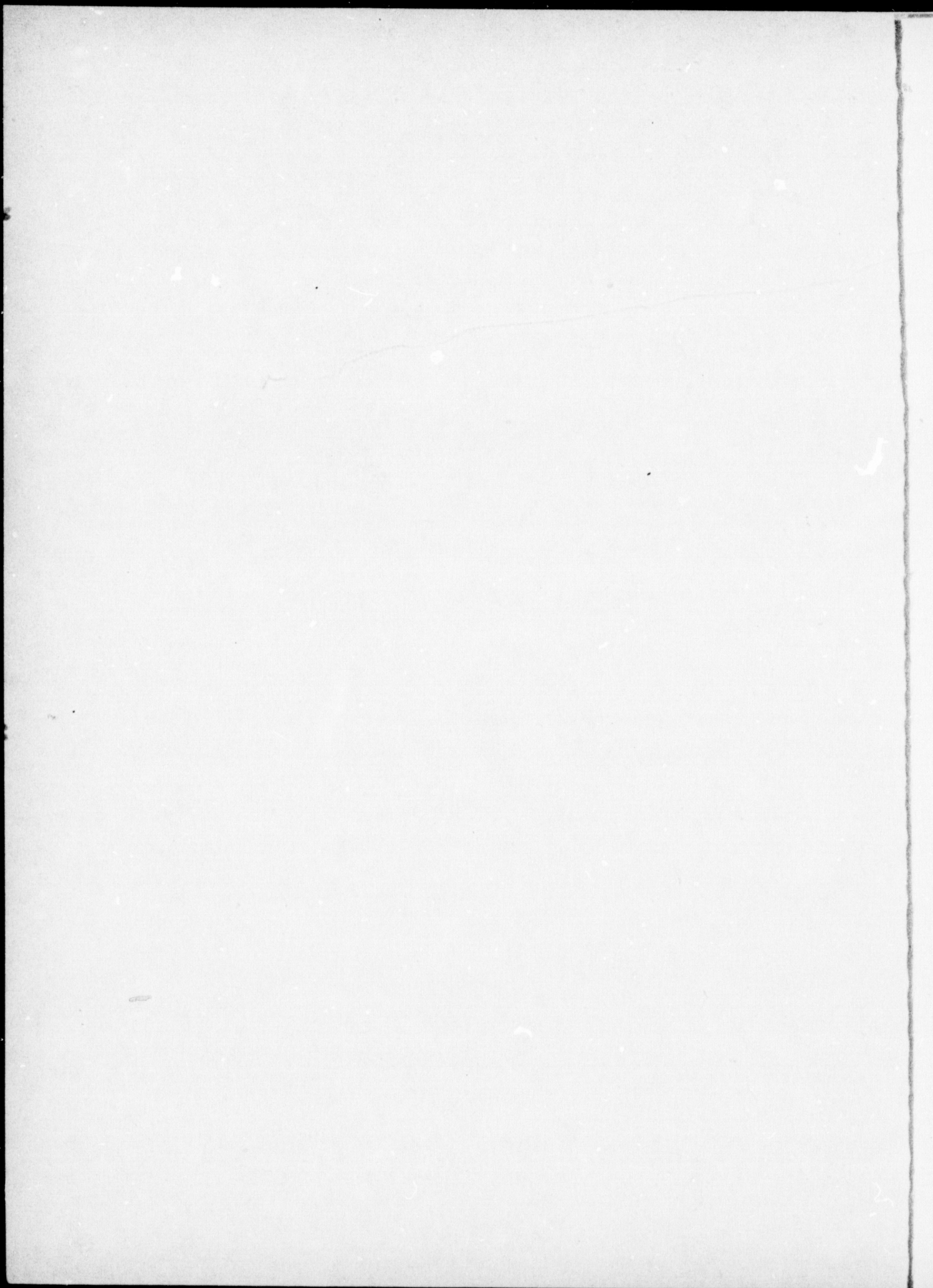
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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

-----x
JEFF SIMON, as Custodian for GAIL NINA SIMON,
Under the New York Uniform Gifts to Minors Act,

Appellant,

- against -

Docket No.
74-1272

THE NEW HAVEN BOARD & CARTON COMPANY,
INCORPORATED, EDWIN W. MILLER, STERLING
R. CHATFIELD, WILLIAM B. GUMBARD, LEON
J. SIMKINS, MORTON H. SIMKINS, DOROTHY
SIMKINS, LEON MELTZER, JACOB J. SIEGAL,
and MALCOLM SANDERS,

Appellees.

-----x
APPELLANT'S BRIEF

STATEMENT OF THE CASE

This is an appeal from a decision of the United States District Court
for the District of Connecticut [S]* dismissing a derivative action brought
by a stockholder of The New Haven Board and Carton Company, Incorporated,
["NH"] and denying any relief after a trial without a jury in New Haven.

*All lettered references are to appellant's Appendix on Appeal.
Appellant is referred herein as "plaintiff" and Appellees as
"defendants".

By COUNT II of his complaint, [B-1] plaintiff sought enforcement by the District Court of the duties of the defendants as officers and directors of NH under §27 of the Securities Exchange Act and redress for their violations of 10b-5* in issuing a deceptive proxy statement urging the merger into NH of certain Florida corporations ["The Miami Companies"] owned by the defendants, Leon J. Simkins, Morton H. Simkins and Dorothy Simkins ["The Simkins"]. Under the same COUNT II, [which incorporated all the allegations of COUNT I], plaintiff sought relief under Connecticut law for the breaches by the defendants of their fiduciary duties to NH in effecting the merger through the numerous acts of fraud upon NH and its stockholders alleged in the Complaint.

The District Court found that the Simkins controlled NH at the time of the merger [S-2,17]. Plaintiff proved at the trial that the defendants in recommending the merger failed to disclose in the proxy statement [F-1] that NH, after seven years of losses, had, in the first fiscal quarter of 1964 [October-December 1963] according to its interim financial statement [Ex. 53]** earned \$148,590 resulting from economies instituted by the Simkins after they took over control of NH in July 1963, as contrasted with an interim loss for the comparable period in fiscal 1963 of \$382,519.

*"10b-5" as used in this brief refers to Section 10[b] of the Securities Exchange Act [15 U.S.C. §76] and Rule 10b-5 promulgated thereunder. Copies of §10[b] of the Act, Rule 10b-5 and §27 are annexed for convenience of the Court.

** i.e., Page 2 of Exh. "B" to Exh. 53. [All references to "Ex." are to Exhibits included in the Record on Appeal.]

[Ex. HH] and the year-end 1963 loss, disclosed in the proxy statement of \$831,702 [F-10]. Plaintiff also proved that the "market price" of \$4.50 for the NH stock on which the defendants based the recommended merger price was not a true market price because of the thinness of the OTC market for NH stock [S-22] and that defendants failed to disclose this fact [F-14]. Plaintiff also proved that the Simkins and their co-defendants failed to disclose [F-15] that the Simkins were in actual control of the NH board which recommended the merger [S-2, Exs.7-14];* that the Simkins had in July 1963 purchased NH stock at prices higher than the merger price [S-17] and made purchases in the open market since that date [Tr. 1132-3],** increasing their holdings to 35.5%; that, contrary to the representations made in the proxy statement [F-6] and 1963 Annual Report [E-2], NH had sufficient credit under the undisclosed terms of a loan from one of the Simkins' companies [H] to obtain a profit of \$455,600. through the discount of a \$2,100,000 NH obligation to Penn Mutual; that NH had a valuable tax-loss carryforward of \$2,073,997 [Ex. 7 [Ex. C thereof] and Ex. 13] which was nowhere disclosed in the proxy materials [Exs. E and F]; that NH was entitled to receive for the 1,377,774 share block of stock

*Thus violating the principle expressed in Mills v. Electric Auto Lite Corp., infra and Mader v. Armel [D. Ohio 1971] '70-'71 CCH Fed. Sec. Rept. ¶93027, p. 90,795.

** i. e., 13,160 shares at undisclosed prices in addition to the 149,371 shares disclosed in the proxy statement [F-15]. [References to "Tr." are to the Trial Transcript.]

proposed to be issued to the Simkins for their Miami Companies a premium for selling to the Simkins legal voting control and liquidation control [S-17,18]; that NH's Grand Avenue property had been contracted to be sold to the City of New Haven at a price representing a profit of \$185,000. over its book value [Exs. 36, 37]* ; that its principal outside investment [35% of the outstanding stock of Grinnell] was worth, according to the undisclosed certified statements of Grinnell [Ex. 54, 55], \$301,130 in excess of the value disclosed in the proxy materials [F-4; E-6]; that the purported "rights" of dissenting stockholders of NH to obtain an appraisal referred to in the proxy statement [F-17] were non-existent; that the "independent" appraisal by the American Appraisal Co. ["AAC"] of their Miami Companies was not adequately presented in the proxy statement [F-6-9] and that, if it were, it would show that the "comparative" financial data set forth in the proxy statement [F-10-13] had been deliberately slanted so as to favor the Miami Companies by giving them the benefit of the turnaround in the industry during late 1963 while failing to credit NH with the same benefits;** that the controlled NH board had never made an independent review of the final AAC appraisal at the meeting of January 16, 1964 approving the merger, or of the proxy statement issued pursuant to their "order" [F-18; Ex. 22, N]; and that

* And see the defendants' delayed disclosure thereof until after the merger: Exs. 63, 64.

**This is demonstrated in extensive detail in POINTS IX through XII of Plaintiff's Post-Trial Brief [Doc. 19, pp. 64-78] and his Reply Brief [Doc. 22, pp. 68-69] and need not be repeated here for the purposes of this Appeal [see Statement of Issues, infra].

the Simkins were deliberately delaying disclosure of the news favorable to NH, including the Penn Mutual and Grand Avenue profits, and the turnaround in NH referred to above, until after they had obtained favorable action by the stockholders [Ex. 63,64; K; Exs. 25,27] so as to obtain for themselves a disproportionate share of the resultant benefits.*

At the trial, the only defendants who appeared to testify were Leon J. Simkins, President and chief executive officer of NH, and William Gumbard. None of the other defendants saw fit to take the stand to defend the actions and omissions proved by plaintiff's documentary proofs [Exs. 1-82]. In their testimony, they admitted that the 'market prices' of NH set forth in the proxy statement were not representative of true value, and the District Court so found in its decision [S-22]. As to the other proven non-disclosures, they defended only with respect to the non-disclosures of NH's turnaround and current interim profits of \$148,590, claiming that the profits were subject to adjustment and incapable of proper disclosure [S-14; Tr. 691-984; Exs. E-H, S-X]**. They attempted no defense, excuse or justification for the remaining non-disclosures. Their expert, Prof. Hunt, was presented to show that, according to a

*Further particular proofs of these non-disclosures need not be reviewed in detail here because of the nature of issues presented for review. Extensive further detail is contained in Plaintiff's Post-Trial Brief [Doc. 19, pp. 24-48, 57-82, 89-94] and his Reply Brief [Doc. 22, pp. 60-85].

**A defense which this Court's recent holding in Republic Technology Fund v. Lionel Corp., cit. infra, makes insufficient as a matter of law.

"discount flow" theory the merger price of \$4.50 was "fair" [S-18-21], taking into account some modest projected increase in earnings post-merger by NH and the benefits of the tax-loss carryforward [O, P, Q, R], as part of the Simkins' effort to show that NH was not damaged by the non-disclosure of the industry and NH turnaround and its interim earnings. In addition, Prof. Hunt admittedly did not even testify to the "fair market value" of the NH block [i. e., the price at which willing buyers and sellers would trade NH stock taking into account the improved earnings][S-18; S-22].

In any event, the Simkins presented no testimony by Prof. Hunt, or any one else, to show that NH was not damaged by the non-disclosures of the concealed assets and profits represented by the Penn Mutual, Grand Avenue and Grinnell matters amounting to a total of \$941,730 or \$2.055 per share of NH as of the merger date [Cf. S-27, N.10], or by the non-disclosure of the facts entitling NH to seek and obtain a control premium.*

Plaintiff presented the testimony of Dr. Douglas Bellemore, a well-known, highly-qualified stock valuation expert who testified as to the damage caused by the non-disclosure of the turnaround and the tax-loss carryforward, and, unlike Prof. Hunt, testified as to what the market value of the NH block would be, without premium for control, based on price

*The District Court also found NH was entitled to a control premium in an undetermined amount [S-17, 18].

earnings ratios for paper company stocks and added thereto a 15% control premium. [Tr. 31-422 Exs. 56-61, 66].* Dr. Bellemore dealt with the real world of buyers and sellers, and, based on their actual purchase of market stocks at the time, reflected in the price: earnings ratios resulting from their trades, determined a price per share for NH at the time of merger of \$7.50 plus a control premium of 15%.

Plaintiff by its complaint invoked the provisions of §27 of the Act [B-24] as follows:

"21. As a court of law and equity, this Court pursuant to Section 27 of the Securities Exchange Act has broad equitable jurisdiction to entertain this derivative action and to fashion any appropriate remedy to right the wrong and injury done to NEW HAVEN as a person injured as a result of the violations of the Securities Exchange Act herein complained of."

and sought an award for all of NH's damages, an award for expenses and counsel fees, and "such other and further relief as "the Court" may deem necessary and proper" [B-25]. In its post-trial brief, plaintiff suggested

* Prof. Hunt acknowledged that a premium was due [Tr. 1087-8]. Dr. Bellemore's testimony was relied upon by Judge Bonsal in Newmark v. RKO General Inc. 305 F. Supp. 310, aff'd 425 F2d 348 [2d Cir. 1970] to award a 15% premium in a 16[b] case. In RKO General, as in the instant case, the block of stock involved represented legal voting control or 56% of Frontier. Without the block, RKO's ownership would be reduced to 43%. Here the difference in ownership achieved by the merger was even greater; i. e., it increased the Simkins ownership from 35.5% to 83.9%. Judge Newman in the decision appealed from nowhere rejected Dr. Bellemore's testimony as to the entitlement of NH to such a premium but rather rejected only his valuation of the NH block without premium based on capitalization of earnings. [S-9-16]

a particular remedy in response to questions by the Court after the trial indicating a desire on its part to benefit the public stockholders of NH to the greatest extent possible, in the event defendants were held liable, and sought an accounting for all gains, benefits and profits not compensated by the suggested remedy [Doc. 19, pp. 108-9]. In its Reply Brief, plaintiff also suggested an alternative or aid to the Court in discharging its duties under the Mills and Borak decisions, infra, that damages could be computed on the basis of the non-disclosures of assets and profits representing \$2.055 per share plus the 15% control premium referred to above [Doc. 22, pp. 85-87] and/or the use of the net asset values of NH as an "alternative" measure [Doc. 22, p. 85 and Doc. 23].

The Court in its decision, after rejecting the Bellemore valuation, failed to determine whether or not defendants violated 10b-5 or state law, as charged [S-8].

It also failed to determine whether, if the violations were proved, NH's damages could be computed by the alternative methods suggested or, indeed, any other appropriate method. Instead, it evaluated the evidence presented and applying, hypothetically, "state" burdens of proof to the Simkins on the assumption they were innocent, [but without so finding], it proceeded to dismiss all of plaintiff's federal and state claims against the Simkins and their co-defendants, on the merits, and to deny not only the claims for monetary damages but also plaintiff's claims for an accounting for profits, injunctive relief, receivership or any other appropriate relief under §27 or state law.

STATEMENT OF ISSUES PRESENTED
FOR REVIEW

1. Did the District Court violate its duties under Rule 52[a] FRCP and the rule in Mills v. Electric Auto Lite Corp. 396 U.S. 375 [1970] by failing, first, to make findings and conclusions as to whether the defendants, or any of them, committed the 10b-5 wrongs and state breaches of trust charged, and, then, to fashion the appropriate remedy or remedies based on those findings, the particular wrongs, misrepresentations and omissions found to have occurred, and their nature, extent and gravity?

Plaintiff contends that it did so err, requiring, at the least, reversal by this Court and remand to the District Court for such findings, with appropriate instructions as to the appropriate federal and state burdens of proof and 10b-5 and state measures of damage or other relief.

2. Did the District Court, in determining NH suffered no damage, erroneously exclude from its consideration the proper 10b-5 measure of damage, by erroneously concluding that it was barred from so doing by the prior decision of Judge Zampano in this action as "law of the case"?

Plaintiff contends that it did, requiring reversal and remand to the District Court.

3. Did the District Court in making its determination that NH suffered no damage apply to the Simkins and their co-defendants the wrong burden of proof under Connecticut law?

Plaintiff contends that it failed to determine and apply the burden applicable to the Simkins as controlling stockholders imposed on them under

Connecticut law to prove not merely "adequacy of consideration" as held by the District Court, but also fairness and honesty, in all respects, including the burden to prove full disclosure in the proxy statement, the burden to negate any damage arising from the wrongs proven by plaintiff, and [where fair market values are relevant] affirmatively to prove the fair market value of all items in dispute, including that of the NH stock at the date of merger and of the control premium which the District Court found was due to NH?

Plaintiff contends that the Court did so err, requiring reversal and remand.

4. Did the District Court err in accepting the testimony of Prof. Hunt in view of the fact the he testified only as to the "fairness" of the merger?

Plaintiff contends that, in so doing, the Court violated the special rule expressed in Mills, supra, concerning the type of proof that corporate management must present on the issue of damages resulting from proxy fraud.

5. Did the District Court err, in determining that NH suffered no damage, without applying to the proofs presented the special principle established by Eastman Kodak, and the 10b-5 cases applying that principle, cited below, whereby all risks of uncertainty as to damage and amount of damage are cast upon proven wrongdoers?

Plaintiff contends that the Court did so err; that he is entitled not only to a determination of wrongdoing under the Mills principle and an award for counsel fees and expenses therefor, if such determination is

in his favor, but also to the benefit of the Eastman Kodak principle which would then obtain and which has not been applied by the Court in its decision.

[Other subsidiary issues are dealt with in the POINTS set forth below relating to the foregoing issues.]

ARGUMENT

POINT I

THE FINDINGS AND CONCLUSIONS IN THE DECISION
APPEALED FROM ARE INSUFFICIENT TO SUPPORT
A JUDGMENT OF DISMISSAL OF ALL OF PLAINTIFF'S
CLAIMS ON THE MERITS AND DENIAL OF ANY RELIEF.

The District Court's decision is founded in its entirety upon an erroneous legal conclusion, namely, that, on the basis of the findings and conclusions incorporated into its decision made after the seven-day trial before it without a jury [S-1 et seq.]:

[a] it could properly dismiss, on the merits, plaintiff's federal derivative cause of action based on 10b-5 [set forth in COUNT II of his Amended Complaint] as well as his pendant derivative state claims against the Simkins and their co-defendants set forth therein; and

[b] it could properly determine that NH was not entitled to any relief either under §27 of the Securities Exchange Act or under its pendant jurisdiction over the state claims [S-23].

The Court erroneously held that it was not required to determine whether the defendants, or any of them, were guilty of the 10b-5 and state wrongs charge [S-8] but was required only to decide and make findings as

to a single issue: whether the "fair market value" of the NH block issued to the Simkins was "in excess of the merger price of \$4.50 per share." [S-23]. Having decided this single issue against the plaintiff, it erroneously concluded therefrom that this established, as a matter of law, the absence of damage to NH and precluded recovery of damage upon any other theory or measure of damage.

As shown in POINT II below, this was error, because the Court failed to apply the proper 10b-5 measure of damage in reaching this conclusion, and failed to weigh all the evidence of damage presented at the trial, on the basis of the proper burdens of proof applicable to proven wrongdoers under federal and state law and to controlling stockholders, such as the Simkins, under Connecticut law.

The Court made no findings or conclusions under Rule 52[a] as to whether or not the Simkins or any of their co-defendants violated 10b-5 or their respective duties under Connecticut law which, for the reasons shown below, were material issues, to say the least. [S-8] *

*All references to "Rules" are to Rules in the Federal Rules of Civil Procedure. Rule 52[a] [a copy of which is included in the Appendix hereto] required that Judge Newman trying the action "without a jury *** to find the facts specially and state separately its conclusions of law thereon." As shown in this brief, the Court made no findings or conclusions as to numerous "material issues", including the basic issue of wrongdoing which affected the determination of other issues, requiring, at the least, vacation of "the judgment and remand for appropriate findings to be made." Moore's Fed. Pract. [1974 ed] §52.06[2], and cases cited therein.

Assuming, arguendo, that the Court's finding that NH suffered no monetary damage measurable by the test used by the District Court was correct, [as, clearly, it was not, for the reasons stated in POINT II below], it is plain that such a finding would not constitute a proper or sufficient legal basis for the Court's decision not only to deny an award for damages, but also [a] to dismiss the complaint on the merits, without determining whether the defendants had violated their federal and state duties, as charged; and [b] to deny all types of relief other than an award for damages as prayed by plaintiff: including an accounting for profits, injunctive relief against future violations, receivership, a declaration that the defendants had violated their statutory duties [as mandated by Mills v. Electric Auto-Lite Corp. supra, even in the absence of monetary damages], the fashioning under the procedure required by Mills of some other remedy or form of relief appropriate to the particular violation or violations found by the Court to have occurred, and the award to plaintiff of its counsel fees and expenses. It is clear that, in the absence of findings and conclusions as to whether defendants committed the violations of 10b-5 as charged, the Court erred in concluding that the complaint could be dismissed and all relief denied, merely on the basis of its finding that NH would not be entitled to an award for monetary damages as against innocent directors.

If the issues of wrongdoing were decided in plaintiff's favor, plaintiff would be clearly entitled, under Mills, to a judicial determination that defendants violated 10b-5 and to an award for counsel fees and expenses for

"having rendered a substantial service to the corporation and its share - holders * * * in vindicating the statutory policy", even if Judge Newman had correctly determined that no monetary award for damages due to the violation could be made [as he did not]. [Mills p. 374-5].

Furthermore, the mere absence of determinable monetary damages, as of the date of merger, did not preclude the District Court from holding that some remedy to NH other than an award for damages was appropriate under the principles enunciated in Mills, such as an accounting for profits, injunctive relief or receivership. Under the rule established in J. I. Case v. Borak 377 U.S. 426 [1963] and followed in Mills [pp. 386-9] and the numerous 10b-5 decisions applying that rule, the District Court can determine which legal or equitable remedy is appropriate only on the basis of the nature, extent and gravity of the particular violations found to have occurred.* As was held in Mills [p. 386]: 'We held in Borak that upon finding a violation the courts were 'to be alert to provide such remedies as are necessary to make effective the congressional purpose' * * * In selecting a remedy the lower courts should exercise 'the sound discretion which guides the determinations of courts of equity' keeping in mind the role of equity as 'the instrument for nice adjustment and reconciliation

*The same is, of course, true with respect to the determination of the appropriate measure of damage and burden of proof, as shown in POINT II below, and with respect to the Court's determination under its pendant jurisdiction of the appropriate remedy for any state law breaches of trust shown.

between the public interest and private needs as well as between competing private claims. "' Borak held [pp. 433-5] that the District Court must provide remedies required to carry out the Congressional purpose of protecting federal rights, that these are not limited to prospective or retrospective relief, but that the overriding federal law controls the measure of redress. [p. 434]. Borak further held that since an action under §27 is "brought to enforce any liability or duties created by this Title", this power to enforce implies the power " 'to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case'" [citing Decker v. Independence Shares Corp. 311 U.S. 282 [1940]]* The application of the Mills and Borak principles to this case demonstrates that the District Court had no right to deny plaintiff's claims for an accounting for profits and his general right to obtain appropriate relief, to be fashioned by the District Court under §27, and the Borak rule, - including an injunction

*As held in SEC v. Capital Gains Research Bureau 375 U.S. 180, 186 [1963] 10b-5 is to be construed "not technically but flexibly to effectuate its remedial purposes." In Gould v. Am. Hawaiian S. S. Co. 362 F. Supp. 771 [1973], the Court held that the Borak principle "has resulted in a wide range of relief reflecting the flexibility of equity jurisdiction."

against future violations and receivership based on the violations proved at the trial, without first making appropriate findings and conclusions determining the issues of wrongdoing.* The mere fact that NH was found not to have suffered out-of-pocket damage of the type dealt with in the Court's decision would not, in and of itself, preclude the granting of equitable relief, including an accounting for profits, once a wrong was shown. Borak's mandate to the District Court requiring it to be "alert" to find and fashion an appropriate remedy based on the wrongs shown obviously can be obeyed only if the Court first makes precise factual findings as to the nature, extent and gravity of the particular wrongs charged, and then fashions the appropriate remedy or remedies in the light of those findings in order to serve the Congressional policy and employing the proper measures of damage and burdens of proof applicable to the particular factual circumstances. The Court erred, therefore, in dismissing plaintiff's federal and state claims in their entirety and denying any relief, without first determining whether or not defendants committed the federal and state wrongs charged. Therefore, the incomplete findings and conclusions which it did make constituted an insufficient legal basis for the judgment which it directed be entered. [S-23, T-1].

*The same applies to the Court's denial of any relief of any type [S-23], for the violations of fiduciary duty by the Simkins, as controlling stockholders, and their co-defendants, as directors, without making any findings or conclusions under its pendant jurisdiction. Such findings were a necessary prerequisite under Rule 52[a] to the dismissal of plaintiff's state claims and the denial of any remedy therefor [S-23].

POINT II

THE DISTRICT COURT HAD NO RIGHT TO DISMISS PLAINTIFF'S CLAIM FOR DAMAGES ON THE BASIS OF THE FINDINGS AND CONCLUSIONS MADE IN ITS DECISION

In addition to its failure to make requisite findings or conclusions on the issues of wrongdoing required by Rule 52[a] and by the Mills rule, the Court made no findings or conclusions as to [a] the applicable measure of damages once 10b-5 violations are shown, [b] the nature and extent of the burden of proof cast upon the defendants once they are proven wrongdoers under federal and Connecticut law, or [c] the nature and extent of the burden of proof cast upon the Simkins under Connecticut law to prove the "entire fairness" of the transaction, required by the District Court's determination [S-2] that the Simkins controlled NH.

As shown in II[A] below, the Court erred in failing to determine and apply the proper measure of damages applicable to a 10b-5 proxy fraud case [as established by Affiliated Ute Citizens v. U.S. 406 U.S. 128, 154-5 [1972] and the other 10b-5 decisions discussed therein] and, instead, applied an erroneous, more restrictive measure of damage based on its misinterpretation of a prior decision of Judge Zampano [250 F. Supp. 297 [1966]] in this action as establishing two types of damage as exclusive, rather than merely illustrative.

As shown in II[B] below, the Court erred in failing to apply to the evidence of damage the liberal rules substantially shifting the burden of proof, especially on the issue of certainty of damage, once wrongdoing is shown under Federal and Connecticut law [as established in Eastman Kodak

Co. v. Southern Photo Materials Co. 273 U.S. 359, 379 [1927] and the other decisions discussed below.]

As shown in II[C] below, the Court erred in failing to cast upon the Simkins, having found them to be controlling stockholders [S-2], the heavy burden of proof established under Connecticut law by the decisions, including Cathedral Estates v. Taft Realty Corp. 228 F.2d 85 [2d Cir. 1959] and Klopot v. Northrop 131 Conn. 14, 137 2d 700, 703 [1944], to prove that the transaction was "entirely fair," in all respects and not merely for "adequate consideration".

II[A] - THE DISTRICT COURT MISCONSTRUED THE
PRIOR DECISION OF JUDGE ZAMPANO AS "LAW OF
THE CASE" AND, AS A RESULT, FAILED TO APPLY
THE PROPER MEASURE OF DAMAGE

Assuming, arguendo, that a District Court could properly determine the existence or extent of damage, without first determining which of the alleged misrepresentations or omissions or state law breaches of duty occurred, and then determining the damage done by the particular misrepresentations, omissions or state law breaches of duty, as clearly it cannot, it is plain that the Court was led to apply an erroneous and overly-restrictive measure of damages by [a] its erroneous conclusion that Judge Zampano's decision restricted the trial Court's later determinations to ascertaining whether NH suffered damage of only two possible types, to the exclusion of all others, and regardless of what might later be shown at the trial or upon an accounting before a Special Master, and [b] its erroneous view of plaintiff's claims for relief. After briefly reviewing

Judge Zampano's denial of defendants' motion to dismiss COUNT II of the Amended Complaint, Judge Newman held [S-6]:

"That ruling on the motion to dismiss is the law of this case. Under the ruling, issuance of shares for less than fair value could produce damages in two ways: [a] loss to the company measured by the difference between the value of the shares issued and the value of the assets received in exchange, and [b] injury to the corporate integrity of the company measured by the damage attributable to any lessened ability to attract public capital investment or to obtain institutional financing as a result of the excess issuance of its shares." [emphasis added]

A reading of Judge Zampano's decision [App. D] establishes that his enumeration of the types of damage which might be proved at the trial was merely illustrative and not intended to constitute an exclusive enumeration of all of the types of damage which might later be proved at the trial or of all appropriate measures of damage.

Judge Newman's error in misconstruing Judge Zampano's enumeration to be exhaustive or exclusive is similar to that of the defendants in Gould v. American Hawaiian S. S. Co. 362 F. Supp. 771 [1973] and in Gerstle v. Gamble Skogmo 298 F. Supp. 66 aff'd 478 F. 2d 1281 [2d Cir. 1973], infra, in misconstruing that portion of Mills dealing with damages as exhaustive or exclusive. As the Court held in Gould:

"The defendants' reliance on the Mills dictum to support their contention that the plaintiffs are not entitled to damages is unfounded. Although the defects are not related to the terms of the merger in the strictest sense of misstating what the shareholders were going to receive, they were directly relevant to the dichotomy between what the favored defendants and the remaining shareholders were to receive. The Supreme Court specifically stated that its statements in Mills were not to be treated as exhaustive or exclusive and they have not been so read. See Gerstle v. Gamble Skogmo, Inc. 478 F.2d 1281 (2nd Cir. May 9, 1973)."

The balance of Judge Newman's decision shows that he erroneously applied to the evidence of damage only the out-of-pocket measure of damage quoted as "type [a]" from the Zampano decision, and excluded from his evaluation of the proofs presented at the trial, any application of "the principle of Janigan v. Taylor 344 F.2d 781, 786-87 [1 Cir.] cert. denied 382 U.S. 879 [1965]; Myzel v. Fields 386 F.2d 718, 748-49 [8 Cir. 1967] cert. denied 390 U.S. 951 [1968], and now Affiliated Ute Citizens v. United States 406 U.S. 128, 154-55 [1972] whereby, in addition to the usual measure of damages, defrauders will be forced to disgorge windfall profits." Zeller v. Bogue Electric Mfg. Corp. 476 F.2d 795, [2d Cir. 1973]. It is impossible to determine, therefore, whether the District Court would have awarded NH an accounting for profits under the above-quoted principle, if it had found against defendants on the issue of misrepresentations and material omissions, and had not erred in concluding that Judge Zampano's decision precluded application of, inter alia, the Ute measure of damages. It is noteworthy in this regard:

[a] that in his complaint [B-28], plaintiff invoked the broad powers of the District Court under §27 of the Act "to fashion any appropriate remedy to right the wrong, and injury done to NEW HAVEN;"

[b] that in his Trial Memorandum filed with the Court prior to the trial [Doc. No. 27] plaintiff sought an accounting in accordance with the Janigan and Myzel principle;

[c] that plaintiff in his Post-Trial Memorandum [Doc. No. 18, pp. 108-9], after suggesting a possible form of relief for out-of-pocket damage

by return of excess shares to NH, demanded "an accounting by all the defendants of all their profits, gains and benefits not compensated by" the suggested award for damages; and

[d] that Judge Newman in his decision recognized that plaintiff was seeking such "an accounting" in addition to "damages." [S-5].

Again, the Court's finding that there was no out-of-pocket damage measurable by capitalized-earnings, even if correct, did not dispense with the requirement that the Court make appropriate findings as to whether NH was entitled to an award for damages based on some other appropriate theory or an accounting for profits, gains or benefits accruing to the defendants, based upon appropriate findings as to whether defendants had violated 10b-5 or breached their state law duties. It is hornbook law that the unavailability of the damages remedy does not bar but rather requires the granting of equitable relief.*

Similarly, Judge Newman's mis-construction of Judge Zampano's decision led him to exclude from his consideration whether NH was damaged by the 10b-5 violations under the measure of damages applied by this Court

*This is especially true here where the Court has a special duty not to leave the invasion of a federal right without a remedy so as to provide for enforcement of the securities laws under §27, Mills, supra, and to provide a remedy against NH's fiduciaries for any acts of self-dealing shown under law, after scrutinizing all aspects of the merger transaction.

in Gerstle v. Gamble-Skogmo 478 F.2d 128[2nd Cir. 1973] to wit, whether the defrauded corporate seller was deprived of the opportunity to obtain a higher merger price, based upon the disclosure of any material facts found by the District Court to have been wrongfully concealed by its corporate officers, or controlling stockholders, from the stockholder body, whose approval was required to effectuate the merger. Accord: Gould v. American Hawaiian S. S. Co. 362 F. Supp. 771[1973]. As held in Gerstle, 1973 CCH ¶93,983, pp. 95,944-7, whether or not damage is shown by this test depends, in part, upon a determination as to which of the particular misrepresentations or omissions were found to have occurred and their nature. *

Thus, in Gerstle, the misrepresentations as to potential profits in the sale of plants were held to have caused damage by depriving the approving stockholders of the opportunity to bargain for and obtain a higher price based on the disclosure of material facts relating to the potential sales of plants, but not to have caused any similar deprivation and damage, as to potential sales of securities. [CCH Fed. Sec. Rep. ¶93,983 at p. 95,946]. If the District Court had applied this test to the evidence showing concealment of material facts relating to NH's right to a control

* This, of course, is another reason that the District Court was required to determine which of the alleged 10b-5 violations were proved, before proceeding to determine damages.

premium and to seek a higher price resulting from an additional \$2.055 per share in assets, profits and potential profits based on the Penn Mutual, Grinnell and Grand Avenue matters [S-27 n.10], as well as the principles governing approximation of damages due from a proven wrongdoer,* it would have had a more than adequate basis for approximating damages to NH, - even if it properly rejected the testimony of both plaintiff's expert and defendant's expert relating to damages arising from the non-disclosure of earnings and the tax-loss carryforward. Cf. Feit v. Leasco Data 332 F. Supp 544 [1971].

There is no way to determine from the decision how the District Court would have determined the issues as to whether or not NH was damaged and the amount of such damage, if it had found that defendants violated 10b-5 and state law, in all the respects charged, and, pursuant to the duties then imposed upon it by Mills, to be "alert" to determine from whatever appropriate test or measure was applicable in the particular circumstances: [a] the actual damages suffered by NH, as well as the potential gains and benefits of which it was wrongfully deprived by the earnings, Penn Mutual, Grand Avenue and other alleged wrongs; and [b] the profits accruing to defendants for which they must account.

Similarly, there is no way of determining from the decision exactly how the Court would have found on the issue of damages, if it had followed the proper procedure of determining NH's entitlement to "equitable

*Cf. II[B] below.

damages" in lieu of rescission of the merger, described by this Court in its recent decision in Crane Co. v. American Standard Inc. 490 F.2d 332 [1974], CCH Fed. Sec. Rep. ¶94,327, pp. 95,122-6. That decision makes it clear that a court of equity must first determine the nature of the wrong before determining "the extent of the relief to be accorded" [p. 95,126], by holding that "the degree of * * * malfeasance" bears on the extent of the equitable damages to be afforded in the circumstances. It there cited "the opinion in Electronic Specialty Co. v. International Controls Corp. 409 F.2d at 947, where after quoting from Hecht Co. v. Bowles, 321 U.S. 329-30 [1944]" this Court "cited 'the admonition of an equally exalted authority' whose 'object all sublime' was to 'let the punishment fit the crime.' " Instead, the District Court assumed that the defendants were innocent [S-8, S-22, S-26, S-27] and it made its determinations denying all relief, including equitable damages on that basis, - contrary to its duties under Rule 52[a], and the decisions cited above. As shown below, it treated the entire action as if all that were involved was a claim that the merger price was "inadequate" or "unfair", and no fraud or overreaching had occurred.

II[B] - THE DISTRICT COURT ERRED IN DETERMINING THAT NH SUFFERED NO DAMAGE, WITHOUT APPLYING THE LIBERAL RULES UNDER FEDERAL AND STATE LAW SHIFTING THE BURDEN OF UNCERTAINTY TO PROVEN WRONGDOERS.

If plaintiff was successful in proving the federal and state wrongdoing charged, he was entitled to have the District Court weigh all of the evidence relating to damages on the basis of the liberal principles of Eastman Kodak, supra; Story Parchment Co. v. Paterson Parchment Paper Co. 282 U.S. 555, 563 [1931] and Bigelow v. RKO Radio Pictures Inc. 327 U.S. 251, 265-6 [1945].* A reading of Judge Newman's decision demonstrates that he failed to find these principles applicable or to apply them. Clearly, an a priori dismissal of plaintiff's claims for damages could be justified only if no damages could possibly be inferred by the trier of fact on any theory, after applying to the evidence presented the liberal principles relating to proof of damages referred to above, on the assumption that all of the numerous charges of 10b-5 violation and state law breached were true. Compare Zeller v. Bogue Electric Mfg. Corp. 476 F.2d 795 [2d Cir. 1973]. Clearly, Judge Newman did just the opposite. One can only speculate as to what he might have determined as the trier of fact as to damages or profits, on the basis of the testimony of the two experts [S-9, S-18], the comparison of the merger price with the July 10, 1963 sales [S-16], damages re-

*Cf. Perlman v. Feldman 219 F.2d 173, 177 [2d Cir.] applying the same principle where a breach of fiduciary duty is shown under state law.

sulting from the failure to disclose the \$2.055 in concealed assets and profits [S-27], etc., if he had applied the Eastman Kodak rule, as Judge Weinstein did in Feit v. Leasco Data 332 F. Supp. 541 [1971] having found that violations occurred.

In Schur v. Salzman 365 F. Supp. 725 [1974] CCH Fed. Sec. Rep. ¶94,370, Judge Weinfeld held in a 16[b] case [p. 95,260] that "the burden of proof is upon the defendant, a fiduciary, to establish that his profits are less than those claimed by the plaintiff, particularly where difficulty in ascertaining the precise damages is due to the insiders' conduct." Thus, such a 16[b] violation was established and the defendant was held to have the burden of uncertainty as to whether or not the \$30 per share received by him constituted short-swing profit in its entirety, or was only partially a short-swing profit, because, as claimed by defendant, it constituted, in whole or part, consideration for the cancellation of an employment agreement. Similarly, in Gould v. American Hawaiian Steamship Co., once it was proved that the defendant violated 10b-5 by failing to disclose material facts upon the basis of which public stockholders could have bargained for a share of a control premium paid to defendants, it was held that they were never afforded the opportunity to share in the premium, and that the defendant bore the risk of uncertainty as to whether such stockholders would have obtained such share and the precise amount of the share and was held accountable for the full amount of the control premium. The District Court held:

"Although it is entirely possible that full disclosure and correction of the material defects would not have affected the terms of the merger and that the favored defendants could have insisted on receiving \$50.00 to vote for and approve the merger, it is similarly equally possible that full disclosure might have resulted in a sharing of the premium. In the opinion of the Court, the defendants, as parties responsible for the accuracy of the proxy materials and responsible for the material defects, should bear the risk of the above uncertainty, and it would be unfair to require the plaintiff to prove that they would have obtained a greater compensation. See generally *Moses v. Burgin*, 445 F.2d 369, 384 [1st Cir. 1971] cert. denied 404 U.S. 994 [1971] and *Mitchell v. Texas Gulf Sulphur Co.*, 446 F. 2d 90 [10th Cir. 1971] cert. denied 404 U.S. 1004 [1971]."

It is clear from a reading of Judge Newman's decision that he resolved all uncertainties as to the fact of damage and the amount of damage against the plaintiff, even in the erroneously-delimited areas of out-of-pocket damage considered by him [S-8 to S-16; S-17; S-18 to S-23; S-25; S-27] and imposed on the plaintiff the burden to show a precise "fair market value" of the NH stock to a certainty [S-25]. Even when the Court assumed arguendo that the defendants might have a certain limited "burden" under Connecticut law, it held that even if the defendants failed to show "adequate consideration" thus rendering the merger voidable, plaintiff would still have the burden to show that the shares were worth "some price" in excess of the merger price and prove its entitlement to recover a "specific amount of money." [S-25].

The plaintiff was clearly entitled to have this issue determined by the trier of fact on the basis of the application of the principles expressed in Bigelow, Eastman and Perlman, all on state and federal issues, and not on the assumption by the District Court that the defendants were innocent,

[S-8, S-22, S-26, N.6, N. 8].

Here, the plaintiff was entitled not only [a] to the determination of the issue of wrongdoing mandated by Rule 52[a] and Mills, but also [b] to have the District Court sitting in place of a jury, "conclude as a matter of just and reasonable inference from the proof of defendants' wrongful acts and their tendency to injure" NH in its rights to obtain the best possible merger price obtainable on the basis of arm's-length dealing, the approximate amount of the damage to NH resulting from the Simkins' deprivation of the opportunity of NH's shareholders to obtain a better merger price based on disclosure of all the facts concealed by the Simkins. Bigelow, supra pp. 264-5.

As in Bigelow, the Simkins' "tortious acts * * * in each case precluded ascertainment of damages more precisely * * *" [p. 264]. In such circumstances, the District Court sitting in place of the jury was "allowed to act upon probable and inferential as well as direct and positive proof" Any other rule would enable the wrongdoer to profit by his wrongdoing at the expense of his victim. It would be an inducement to make wrongdoing so effective and complete in every case as to preclude recovery, by rendering the measure of damages uncertain. Failure to apply it would mean the more grievous the wrong done, the less likelihood there would be of a recovery." This principle applies, a fortiori, here, where each of the defendants is a fiduciary and all of the uncertainties relied upon by them were created by their own wrongdoing Pappas v. Moss 305 F Supp 1257, 1259 [on remand]. Feit v. Leasco Data, supra.

"The constant tendency of the Courts is to find some way in which damages can be awarded where a wrong is done. Difficulty of ascertainment is no longer confused with right of recovery' for a proven invasion of the plaintiff's rights." Bigelow pp. 265-266 citing Story, supra.

II[C] - THE DISTRICT COURT ERRED IN FAILING TO
CAST UPON THE SIMKINS THE BURDEN IMPOSED BY
CONNECTICUT LAW UPON CONTROLLING STOCK-
HOLDERS WHO HAVE DOMINATED THE TRANSACTION
BETWEEN THE CORPORATION AND THEMSELVES.

Judge Newman in his decision considered how Connecticut's General Statute §33-323, which governs the voidability of transactions with directors merely because of their interest [in the absence of fraud, breach of trust or other factors], affects the burden of proof of certain aspects of the damage issue, to wit, general "fairness" of the merger price and "adequacy of consideration". However, he made no definitive findings or conclusions as to which party has the burden of proof under the statute on all aspects of fairness. [S-8 and N.5]. It is also clear that he made no determination as to [a] the nature or extent of the burden of proof imposed by Connecticut law upon the Simkins, as controlling stockholders dominating the merger; or [b] the nature and extent of the burden of proof imposed by Connecticut law on their co-defendants who ordered the issuance of the fraudulent proxy statement, in the event they were proved to have breached their fiduciary duty. A reading of the applicable decisions under Connecticut law demonstrates that the actual burden imposed upon the Simkins is far heavier than the limited "burden" which the District Court posited as arising under

§33-323 [S-8] and found, hypothetically, [S-21-23] that defendants had met by means of Prof. Hunt's testimony. Under Judge Newman's construction of the statute, [S-8, S-25], defendants' obligation was limited to showing "fairness" of "the price of the New Haven shares" and not to showing the fairness of the entire transaction "in all respects". However, the cases make it clear that the broader obligation obtains where, in addition to being interested in a transaction, it is shown that the self-dealing directors controlled the corporation and, therefore, dominated the transaction. Cathedral Estates v. Taft Realty Corp. 157 F. Supp. 895 [D. Conn. 1957] aff'd [2d Cir.] 228 F. 2d 85, 251 F. 2d 340.* The Court's finding that it need not reach "the issues of whether or not a material misrepresentation or omission occurred" [S-8] in determining whether the merger was "fair" under Connecticut law and that "the price of the New Haven shares is the only factor" it needed to determine in denying pendant state relief to plaintiff under COUNT II are clearly erroneous interpretations of Connecticut law. The burden actually imposed on the Simkins, pursuant to the Cathedral Estates decision, and the cases cited therein, was to show that the transaction was fair "in all its aspects" including, but not limited to, "adequacy of consideration" [228 F.2d at 87]. The Simkins had the burden

*The distinction between the standard of technical compliance with a statute such as §33-323 and compliance with common law duties of a director is well expressed in Remillard Brick Co. v. Remillard Dandini Co. 10 Cal. App. 2d 405, 241 P. 2d 60 [1952].

of showing that the merger was "entirely fair", honest, made in good faith, and upon a full understanding. Cathedral, Klopot v. Northrop 131 Conn. 14, 37 A2d 700, 703, Sundlund v. Newark Shipbuilding Co. 135 Conn. 108, 61 A2d 665.

In Pappas v. Moss 393 F 2d 865 [1968], the Court of Appeals reversed the determination of the District Court [257 F. Supp. 345] which erroneously failed to place on the defendants the burden of proof, as interested directors, "to establish by clear and convincing proof that the transaction was honest, fair and reasonable." Upon remand [303 F. Supp 1257 [1959], Judge Wortendyke determined that the defendants "did not sustain their state burden of proving that the \$6 price was honest, fair or reasonable. It could not be honest because of the defendants' failure to reveal the turn-around and allow the stock market time to react to it, prior to their entering into the transactions in question." [p. 1262]. Similarly, in the instant case, the Simkins had the entire burden to prove the \$4.50 merger price was "honest" in all respects, in the same sense, in order to prove "fairness" under Connecticut law.

Cathedral establishes also that the Connecticut burden imposed on the Simkins because of Judge Newman's finding that they controlled NH would require not merely that they prove that the merger price was generally "fair" according to the "discount flow" analysis of Prof. Hunt, but also that they prove affirmatively by competent evidence the precise fair market value of the corporate stock being transferred to them. [157 F. Supp. 895, 902]. There, Chief Judge Smith of the Connecticut District Court held that, although the controlling stockholders sustained their

burden to prove that the "fair market value" of the hotel was equal to the purchase price, they failed to sustain their burden of proving that the "fair market value" of the purchase money note and mortgage given to the selling corporation was \$315,000. Judge Smith pointed out the heavy burden imposed on Connecticut controlling stockholders "by their fiduciary capacity of showing the entire fairness of the transaction" and that "A corporate majority may not, in the absence of express statutory authority, force a minority to sell, regardless of the fairness of the price offered." [p. 897]*. The only competent evidence presented as to what the fair market value of the NH block would be, had the defendants disclosed [a] the "turnaround", [b] NH's current quarterly earnings, [c] the existence of the tax-loss carryforward; and [d] the facts relating to NH's entitlement to a 15% premium for the increase from working control to actual legal voting control and liquidation control was that of plaintiff's expert stock appraiser, Dr. Douglas Bellemore.** The defendants, therefore, failed to present any

*Accord: Perlman v. Feldmann 219 F.2d 173 [2d Cir.] where this Court held that, where a breach of fiduciary duty is shown, it is the defendants fiduciaries who have the burden to prove "the value of the defendant's stock without the appurtenant control over the corporation's output of steel", so that the quantum of damages based on the amount of premium could be established.

**Neither Dr. Bellemore nor Prof. Hunt testified as to the effect on the value of the NH stock had the \$2.055 in hidden assets and profits been disclosed.

evidence as to what the "fair market value" of the NH block was, had the defendants made the disclosures referred to above, and thus failed to sustain their state law burden of demonstrating "adequacy of consideration". Clearly, the standard of proof posited by Judge Newman as satisfying the state burden as to "adequacy of consideration" fell far short of the requirements of Connecticut law.* As the Court found, on p. 18:

"Professor Hunt acknowledged that he was not endeavoring to determine a precise market value for New Haven shares. Instead he sought to determine, by what he called a "discounting flows" analysis, whether the merger price of \$4.50 per share was too low."

The District Court erred in not finding that the Simkins' burden, as fiduciaries in exclusive control of all the relevant data and inside information, was to show affirmatively that NH was not damaged in any way by their breaches of duty to NH, including their misrepresentations and material omissions, not only as a result of the issuance of stock at less than "fair market value". Perlman v. Feldmann 219 F.2d 173 [2d Cir.]

In any event, even if the Court did not misconstrue the state burden imposed on the Simkins to show "adequacy of consideration" in the absence of fraud or breach of trust, as clearly it did, it erred in holding that the only issue of "fairness" on the evidence presented related to "adequacy of consideration" and in failing to impose upon the Simkins, in

*e.g., at S-22, although the Court acknowledges that defendants' evidence, including Hunt's testimony, failed to "prove a precise fair market value" and was "not entirely satisfactory," it came to the conclusion the state burden was met.

addition, the burden to show fairness and honesty of disclosure in the proxy statement. [Plaintiff contends that the Simkins and the other defendants failed, as a matter of law, to sustain their state burden on the issue of adequacy of disclosure for the reasons set forth below because, even giving the testimony presented by them full credence, they failed to establish any legally-sufficient justification or defense for the only non-disclosure dealt with at all in their case, to wit, the failure to set forth in the proxy statement NH's current interim earnings with appropriate qualifications. Republic Technology Fund v. Lionel Corp. 483 F. 2d 540 [2d Cir. 1973] Republic, cited in the District Court's decision [S-1], establishes that the only defense made by the Simkins, to wit, impossibility of disclosure of NH's current earnings, was insufficient as a matter of law,]

POINT III

THE SIMKINS FAILED TO DISCHARGE THEIR STATE
BURDEN TO NEGATE PLAINTIFF'S CLAIMS THAT
EACH OF THE ALLEGED NON-DISCLOSURES DAMAGED
NEW HAVEN

Under this Court's decisions in Cathedral Estates v. Taft Realty, supra, and Perlman v. Feldmann, supra, the Simkins had the burden to negate plaintiff's claims that each of the alleged non-disclosures damaged New Haven. The Simkins failed to discharge that burden and the District Court failed to make any findings or conclusions as to whether they did, as required by Rule 52[a]. The testimony of Prof. Hunt did not discharge that burden. Prof. Hunt clearly did not testify as to whether the dis-

disclosure of the \$2.055 per share in concealed assets and profits and the concealed facts showing NH's right to a control premium for the block being issued would have resulted in a value for NH stock in excess of the merger price. At the most, Prof. Hunt's testimony related to whether the disclosure of the concealed "turnaround" and tax-loss carryforward would have resulted in a "discount flow" value for the NH stock in excess of the \$4.50 merger price. Therefore, even giving Prof. Hunt full weight, it did not sustain the state law burden of proof imposed upon the Simkins under Cathedral Estates and Perlman to negate plaintiff's claim that the non-disclosures of the \$2.055 per share in concealed assets and profits and all of the other non-disclosures proved [with the exception of the concealed "turnaround" and tax loss carryforward] damaged NH. Therefore, the District Court's conclusion [S-22] that the Simkins sustained their state burden was erroneous, as a matter of law.

In actuality, Prof. Hunt's testimony amounted to nothing more than proof of general "fairness" of the merger which Mills, supra, clearly held must be rejected as insufficient to show the absence of damage due to proxy fraud, as was clearly held in Mills, supra, for the sound policy reasons stated therein [pp.381-2].

POINT IV

THE COURT ERRED IN FAILING TO USE NH'S NET ASSET VALUES AS A BASIS FOR DETERMINING DAMAGE TO NH, ONCE IT DETERMINED CAPITALIZATION OF EARNINGS WAS NOT APPROPRIATE.

The District Court erred in another distinct respect: Having determined that valuation by capitalization of NH's earnings was not appropriate [S-9], it should have followed the rule stated in Norte & Co. v. Huffines 288 F. Supp. 855 S.D.N.Y. [1968] cited in its decision [569], namely, in the absence of representative market prices and significant earnings which may be capitalized, to determine fair market value of a security, by its net asset value. [288 F. Supp. at 859]. There, as here, the District Court found the valuation by capitalization of earnings was inappropriate because of recent losses [p. 859] and rejected market prices because of the thinness of the market of the Defiance stock* and therefore turned to "asset value, the principal alternative to the capitalization of earnings approach." [p. 859].

The District Court nowhere explains why, having rejected the capitalization-of-earnings approach, it nevertheless accepted Prof. Hunt's analysis as sufficient, even though, admittedly, it did not prove "fair market value" of the NH block.

* Cf. Application of Marcus 273 App.Div. 725 727 [1st Dept. 1948] app. dis. 277 App.Div. 963 affd. 303 N.Y. 711.

Clearly, if the District Court had found the defendants guilty of violating 10b-5, it would have been required under Mills to go beyond its rejection of the capitalization-of-earnings method and to determine the fair market value of the NH block without premium based on NH's net asset values and the next most appropriate method. Norte v. Huffines, supra.

Similarly, if defendants were found to have made all of the misrepresentations charged, the Court's failure to consider other appropriate measures of damage [including the Ute and Gerstle measures] could not be justified. Findings of 10b-5 violation would have required it, under the Mills decision, to be "alert" to find a remedy in the light of the wrongs proved.* Furthermore, the state law requirement that the Court must scrutinize every self-dealing transaction of controlling stockholders, on its own, and as an agency of the public interest, and not be limited even by the respective positions of the litigants, was not followed in Judge Newman's decision. Cf. Cathedral Estates, supra, Pepper v. Litton 308 U.S. 295 [1939], Geddes v. Anaconda Copper Mining Co. 254 U.S. 590. [1920].

*Feit v. Leasco Data, supra, Gerstle, supra, and Gould, supra. The Court's statement in footnote 10 that plaintiff made "no claim that a price per share in excess of \$4.50 could be established by net asset values" is not supported by the record. By his Reply Brief, as amplified by letter of February 28, 1973 [Doc. 22 and 23], plaintiff clearly claimed that net asset values could be used as an alternative method of valuation of the NH stock.

Thus, the Court erred in rejecting plaintiff's contention that, even if the Court were to determine that out-of-pocket damage due to the non-disclosures of interim earnings and tax-loss carryforward were not proven by the Bellemore capitalization-of-earnings testimony, NH was nevertheless entitled to recover damages in the amount of \$2.055 per share due to the non-inclusion within the \$4.50 merger price of the "assets and transactions that plaintiff alleges were not properly reflected in the materials sent to NH shareholders at the time of the merger" [S-27, ¶.10]. Its reasons for so doing were insufficient, as a matter of law. Under the Court's approach, plaintiff was required to demonstrate that the merger price of \$4.50, represented by defendants in the proxy materials to reflect true market prices, constituted "real market value" in order to prove such damages in the amount of \$2.055 plus control premium. This was error: Defendants should have been estopped from denying that the "real market value" of the NH stock without control premium or any of the other elements of value concealed by them from NH's stockholders was at least \$4.50, since that is what they represented to the NH stockholders, and that is what the stockholders presumably relied upon in approving the merger price, without the inclusion of the \$2.055 and a control premium. Cf. Republic Technology Fund v. Lionel Corp. 483 F.2d 540 [2d Cir. [1973], cert. denied ____ U.S. ____]. Thus, the plaintiff's proof that \$2.055 in values and facts showing entitlement to 15% control premium were not included in the proxy materials, would establish that NH was damaged by that amount. Furthermore, under the Gerstle and Gould measures of damage, it is sufficient

to show that defendants' misrepresentations deprived NH's stockholders of the opportunity to bargain for the control premium and the \$2.055 in concealed profits and assets, and this showing shifts all risks of uncertainties to the defendants. As stated above, Judge Newman's second reason in footnote 10 for rejecting plaintiff's "alternative" theory of damage, was that plaintiff made no claim that the "net asset value" of NH stock [\$12.00 per share*] exceeded the \$4.50 merger price, to which "net asset value could be added whatever per share increment could be accepted from plaintiff's claim of undisclosed profits and assets of \$2.055 per share. " This finding is not supported by the record. [Doc. 22 and 23].

If Judge Newman had found defendants guilty of the wrongs charged, he would have been required to resolve all uncertainties as to each factual issue relating to damage, including, inter alia, those involving the "fair market value" of the NH block dealt with in his decision,** against the defendants rather than in their favor, as he did. Thus, although he found that NH was entitled to a "control premium" on the block issued to the Simkins in 1964, he failed to award to NH the 15% to which Dr. Bellemore testified without contradiction it was entitled. *** Instead, the Court found, without any proof from defendants on the subject, that the premium due was

*Cf. F-12.

**As well as the issues relating to capitalization of earnings and the projection base used by Dr. Bellemore, and the comparable sales in July 1963. [S-9 to S-22].

***Contrast the treatment of the evidence of premium in Gould v. American Hawaiian S. S. Co., supra, p. 19.

"considerably smaller" than that due in July 1963 [S-18], but failed to fix the amount. Defendant's expert conceded that the premium should average 10% [Tr. 1088]. Thus, under the Gould rule, NH should have received at least the premium due as its damages.

It is also noteworthy that, under the Eastman Kodak principle, if the Court had found the Simkins to have been wrongdoers, its own findings as to the July 1963 sales [S-17] would have constituted a sufficient basis on which to approximate NH's damages. The Court found [S-17] that the average selling price in July 1963 of \$4.64 was comparable, but concluded that the price included a premium for control.* Even if defendants were to be granted a full 15% for the July 1963 premium [though they never proved it], a "base price" without control premium of \$4.035 is established, to which the Court could add the control premium for the January 1964 block, which it found to be due to NH, plus the \$2.055 per share of concealed assets and profits, thereby resulting in damages to NH of \$2.195 per share for a total of \$3,024,214.

*Again, erroneously, because the Simkins failed affirmatively to prove that a July 1963 premium was paid. The proof was to the contrary. Albemarle was anxious to sell to take care of its Ethyl investment and reduced its asking price [Tr. 842-3; 873; Exs. 8,10]. Working control was actually acquired by paying \$4.88 per share to directors who resigned and their associates. [Ex. 44, and also see Exs. 8 and 10].

If the Court were to allow only the 10% premium conceded by defendants' Prof. Hunt [Tr. 1088], this would result in damages of \$2,746,592. And if the Court elected to use "net asset values", the damages would total \$16,069,254 [using a 15% premium] and \$15,101,092 [using a 10% premium].

We do not suggest that these are the only appropriate or even the only correct measures, but we offer them only to prove the highly prejudicial effect of the Court's errors in not applying the proper burdens of proof on the issue of damages and in determining, in effect, that NH must go without remedy, even if it were defrauded by its directors and controlling stockholders.

CONCLUSION

Based upon the foregoing contentions, plaintiff respectfully requests that this Court reverse the Decision and Judgment from which he has appealed, make findings and conclusions that the defendants violated 10b-5, as well as their respective duties as directors and controlling stockholders under Connecticut law, in each of the respects charged by plaintiff, and remand this action to the District Court, with directions, first to award to plaintiff his reasonable counsel fees and expenses to be determined by the District Court in accordance with the Mills decision, supra, for having obtained such determination of violations against defendants and in favor of, and for the benefit of, The New Haven Board & Carton Company, Inc., ["NH"], and, then, to determine the issues of damages, accounting for profits, injunctive relief and other appropriate relief to NH in a manner consistent with the legal rules and principles set forth above or as may be determined by this Court; and, in the alternative, respectfully request that this Court, upon such reversal, remand this action to the District Court to make all appropriate findings of fact and conclusions of law, pursuant to Rule 52[a], determining whether defendants, or any of them, violated 10b-5 or Connecticut law, and, inter alia, directing that the burden of proof on the issue of adequacy of disclosure was on the defendants under Connecticut law, and that the legal defense presented by defendants on the issue of non-disclosure of interim earnings and turnaround, was insufficient as a matter of law; and further directing that, if the District Court find any

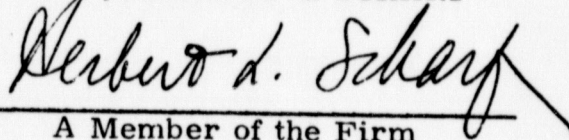
one or more such violations to have occurred, plaintiff be awarded his reasonable counsel fees and expenses under the Mills rule, for having obtained such determination against defendants, or any of them, and in favor of, and for the benefit of, NH, and further directing that the District Court should thereupon determine the issues of damages, accounting for profits injunctive relief, and other appropriate relief to NH for such violations, in a manner consistent with all of the legal rules and principles set forth above, or as this Court may determine, and with appropriate directions from this Court as to, inter alia, measures of damage and burdens of proof under federal and Connecticut law, and providing for such other and further relief or appropriate directions to the District Court, as this Court shall find just and appropriate in the circumstances.

Respectfully submitted,

Dated: May 3, 1974

BOBROFF, OLONOFF & SCHARF

By



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APPENDIX TO APPELLANT'S BRIEF

- (1) Federal Rules of Civil Procedure; Rule 52(a):

FINDINGS BY THE COURT

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

- (2) Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C.

78j):

Regulation of the use of manipulative and deceptive devices.

It shall be unlawful for any person, directly, or indirectly, by the use of any means or instrumentality of interstate commerce or

of the mails, or of any facility of any national securities exchange- ***

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (June 6, 1934, c. 404, Title I, § 10, 48 Stat. 891).

(3) § 27 of the Securities Exchange Act of 1934 (15 U.S. § 78aa):

Jurisdiction of offenses and suits. - The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title (§§78a-78d, 78e-78l, 78m-78o, 78o-3-78hh of this title) or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title (§§78a-78d, 78e-78l, 78m-78o, 78o-3--78hh of this title) or the rules and regulations thereunder. *** Any suit or action to enforce any liability or duty created by this title (§§78a-78d, 78e-78l, 78m-78o, 78o-3-78hh of this title) or rules and regulations thereunder, or to enjoin any violation of such title (§§78a-78d, 78e-78l, 78m-78o, 78o-3-78hh of this title) or rules and regulations, may be brought in any such district or in the district wherein the defendant is

found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). *** (June 6, 1934, c. 404, Title I, § 27, 48 Stat. 902).

(4) Rule 10b-5 of the Rules promulgated by the Securities & Exchange Commission:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

United States Court of Appeals for the Second Circuit

Jeff Simone, etc., Appellant

against

The New Haven Board & Carton Co., Inc., Edwin W. Miller, Sterling
R. Chatfield, William B. Gumbard, Leon J. Simkins, et al., Appellees

State of New York, County of New York, ss.:

Bernard S. Greenberg, being duly sworn deposes and says that he is
agent for Bobroff, Olonoff & Scharf, the attorneys

for the above named Appellant herein. That he is over

21 years of age, is not a party to the action and resides at 162 East Seventh Street
New York, N.Y..

That on the 3rd day of May, 1974 he served the within

Brief for Appellant

upon the attorneys for the parties and at the addresses as specified below

Tyler, Cooper, Grant, Bowerman & Keefe,
Attorneys for Appellee William B. Gumbart
Ppst Office Box 1936, 205 Church Street, New Haven, Connecticut 06509Wiggin & Dana
Attorneys for all other Appellees,
205 Church Street,
New Haven, Connecticut 06509by depositing two true copies
to each of the same securely enclosed in a post-paid wrapper in the Post Office regularly main-
tained by the United States Government at
90 Church Street, New York, New York
directed to the said attorneys for the parties as listed above at the addresses aforementioned,that being the addresses within the state designated by them for that purpose, or the places
where they then kept offices between which places there then was and now is a regular com-
munication by mail.

Sworn to before me, this 3rd

day of May, 1974

Bernard S. Greenberg

Roland W. Johnson

ROLAND W. JOHNSON
Notary Public, State of New York
No. 4509705Qualified in Delaware County
Commission Expires March 30, 1975